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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking in the Review)
of the California High Cost Fund B Program) R.06-06-028
_____)

**REPLY COMMENTS OF SPRINT NEXTEL
ON ASSIGNED COMMISSIONER'S RULING
REGARDING THE SCOPING AND SCHEDULING OF PHASE II ISSUES**

Introduction

Pursuant to the November 15, 2007 electronic mail ruling of the Assigned Administrative Law Judge, Sprint Communications Company, L.P. (U 5112 C), Sprint Telephony PCS, L.P. (U 3064 C), Sprint Spectrum L.P. as agent for Wireless Co., L.P. (U 3062 C) *dba* Sprint PCS, and Nextel of California, Inc. (U 3066 C) (collectively, "Sprint Nextel"), respectfully submit these Reply Comments on the October 5, 2007 Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues ("the ACR") in the above-captioned proceeding.¹

Summary

The Commission will encounter substantial difficulties in attempting to accomplish two of the tasks envisioned in the ACR, namely, conducting a reverse auction to identify a carrier of last resort ("COLR")² and using the HM 5.3 Model to update cost proxies.³ Review of the comments filed by other parties reveals that these tasks will prove complex, costly, contentious, and, above all, time-consuming. If not done correctly, these tasks will result in incumbent local exchange carriers ("ILECs"), such as AT&T California ("AT&T") and Verizon California ("Verizon"), continuing to receive undue and anticompetitive subsidies that harm consumers in numerous ways. But even if they are done correctly, these tasks will require far more time than

¹ Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues, *filed* October 5, 2007, available at <http://docs.cpuc.ca.gov/efile/RULINGS/73607.pdf>.

² *See id.* at 3.

³ *See id.* at 5.

should be required for removal of existing price caps on basic service rates. Removal of price caps would eliminate any need for continuing the California High Cost Fund-B (“CHCF-B”) program. The Commission should therefore focus on removing basic service price caps as quickly as possible. Rather than devote its already strained resources to a reverse auction or cost proxy update using the HM 5.3 Model, the Commission should target January 1, 2010 as the date for removal of all price caps, and use the next two years to devise and implement an appropriate transition to market-based rates. As discussed below, this would include changes in the Universal Lifeline Telephone Service (“ULTS”) program to ensure that: (a) adequate financial support is available for Lifeline customers and (b) ULTS subsidies are available on a competitively and technologically neutral basis.

Discussion

I. THE COMMISSION SHOULD RECONSIDER THE AGENDA IT ADOPTED IN D.07-09-029.

In Decision (D.) 07-09-020,⁴ the Commission envisioned that, with relatively little difficulty, it could swiftly accomplish the following tasks: (1) create a new California Advanced Services Fund (“CASF”) funded by monies drawn from the California High Cost Fund-B program; (2) develop and implement a “reverse auction” to identify a single COLR, or multiple COLRs, for alleged high cost areas where the cost of providing basic service exceeds the \$36 high cost benchmark adopted in D.07-09-020; (3) use the HM 5.3 Model to update cost “proxies,” *i.e.*, the estimated cost of providing basic service in Census Block Groups (“CBGs”)

⁴ *Order Instituting Rulemaking into the Review of the California High Cost Fund-B Program*, R.06-06-028, Interim Opinion Adopting Reforms to the High Cost Fund-B Mechanism [D.07-09-020] (2007) __ CPUC 2d __, 2007 Cal. PUC LEXIS 429 (“D.07-09-020”), available at: http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/72734.doc, amended *Order Instituting Rulemaking into the Review of the California High Cost Fund-B Program*, R.06-06-028, Order Correcting Errors in Decision 07-09-020 [D.07-11-039] (2007) __ CPUC 2d __, 2007 Cal. PUC LEXIS __ (“D.07-11-039”), available at: http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/75379.doc, application for rehearing filed October 9, 2007 by The Utility Reform Network (“TURN”). (All references herein to D.07-09-020 and D.07-11-039 are to the Commission’s *mimeo.* prints of these decisions.)

generated through use of the Cost Proxy Model (“CPM”) in D.96-10-066,⁵ and (4) adopt a schedule for allowing existing price caps on the ILECs’ basic services to rise as of January 1, 2009, toward the \$36 benchmark.⁶

The Commission deserves credit for the scope of the agenda envisioned in D.07-09-020 and for seeking to complete the transition to “cost-based rates, as disciplined by competitive market forces.”⁷ Sprint Nextel is gratified to see the course adopted in D.07-09-020, especially the decisive reduction, by nearly 75 percent, in the size of the CHCF-B program.⁸ This reduction was, and is, essential to ensuring that Californians are not unduly burdened and that ILECs do not receive anticompetitive subsidies that are no longer necessary or deserved. However, having come so far, the Commission should not allow the high cost fund to swell once again into a multi-hundred-million-dollar subsidy scheme that benefits a few incumbent telephone companies.

In view of comments the Commission has received since D.07-09-020 was adopted, the Commission should recalibrate the agenda envisioned in D.07-09-020. Taken as a whole, the agenda is too ambitious. In view of the already evident discord among the parties, which is discussed below, and due to the nature of the Commission’s procedures, it will likely not be possible to complete the tasks identified in D.07-09-020 in a reasonable amount of time. This will delay the transition to fully competitive markets, a delay that will benefit not consumers, but

⁵ *Rulemaking on the Commission’s Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643*, R.95-01-020; *Investigation on the Commission’s Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643*, I.95-01-021; Opinion [D.96-10-066] (1996) 68 CPUC 2d 524, 1996 Cal. PUC LEXIS 1046 (“D.96-10-066”).

⁶ See D.07-09-020 at 96 (“Therefore, we shall adopt a phased-in schedule to take effect beginning January 1, 2008, to begin transitioning from the current basic rate levels toward the goal of cost-based rates, as disciplined by competitive market forces. During this phase-in period, we shall impose caps on the maximum level that the COLR may charge for basic service, subject to gradual step increases over a prescribed time period until the rate cap rises to a level to be determined in Phase II” of this rulemaking. “In this manner,” the Commission observed, “any potential ‘rate shock’ will be avoided.”).

⁷ *Id.*

⁸ *Id.* at 41.

only the ILECs.⁹ Sprint Nextel is concerned that, unless the Commission changes its agenda, the ILECs will continue to receive undue (and, unfortunately, likely even higher) subsidies from the CHCF-B program well into the indefinite future.¹⁰ This is an outcome that harms competition, harms consumers, and, as mentioned, helps only the ILECs. Had they planned it themselves, the ILECs could not have hoped for a better possible outcome.

Just as parties' comments on CASF-related issues indicated significant practical and legal obstacles to creation and implementation of the CASF,¹¹ so also do the opening comments on non-CASF-related issues, filed on November 9, 2007, make it clear that the Commission is now at risk of embarking on a set of costly and time-consuming undertakings that are likely to prove unproductive. As the Opening Comments of the Division of Ratepayer Advocates ("DRA") point out, the Commission will not necessarily be doing consumers a favor in using the HM 5.3 Model to update CPM-based cost proxies.¹² Because of the disagreements among the parties, there is no easy or quick road to accomplishing what was envisioned in D.07-09-020. The Commission should take a step back and ask whether the tasks envisioned in D.07-09-020 are reasonably feasible or not.

⁹ Even D.07-09-020 reflects uncertainty regarding the need for and value of updating the CPM-generated proxies through use of the HM 5.3 Model. *See, e.g., id.* at 118-19 ("Any trade-offs between modeling accuracy and additional workload must be weighed within the context of the limited timeframe within which such proxies would apply before the reverse auction took effect").

¹⁰ Because it competes against the ILECs' wireless affiliates, Sprint Nextel is of necessity concerned about AT&T and Verizon continuing to receive millions of dollars in "free cash" through CHCF-B payments – payments that are possible because of a surcharge levied on Sprint Nextel's customers. By definition, this is not a fair marketplace.

¹¹ The Assigned Commissioner recently released a Proposed Decision that would, if adopted by the Commission, create the CASF. *See Order Instituting Rulemaking into the Review of the California High Cost Fund B Program*, R.06-06-028, Proposed Decision of Commissioner Chong, "Interim Opinion Implementing California Advanced Services Fund," mailed November 20, 2007. Parties' opening comments on the proposed decision are not due until December 10, 2007.

¹² *See* Opening Comments of the Division of Ratepayer Advocates on Phase II Issues, filed November 9, 2007 ("DRA Comments") at 17. DRA forecasts the possibility that CHCF-B draws by Verizon alone, even with the \$36 benchmark, would cost consumers an additional \$45 million in subsidies to Verizon. The \$45 million price tag does not include the additional cost of subsidy payments to AT&T as a result of using HM 5.3-generated cost estimates, but the cost is likely to be substantial, since AT&T (as discussed *infra*) does not advocate *any* changes in the HM 5.3 Model. *See* AT&T Comments at 20-21.

If the Commission moves quickly and efficiently toward removal of basic service price caps, it will no longer be necessary to continue the CHCF-B program. If the Commission properly ends the CHCF-B program, then: (a) CHCF-B program funds will not be available for or misapplied in funding a CASF program; (b) there will not be any need for a reverse auction to determine which carrier(s) should receive CHCF-B monies, and (c) there will not be any need to update the CPM-based “proxies” through use of the HM 5.3 Model.

The following information from DRA’s Comments underscores Sprint Nextel’s point. According to DRA, AT&T’s *entire* monthly draw from the CHCF-B, *even before* D.07-09-020, could be offset by an increase of only \$3.43 per month per residential line.¹³ Post-D.07-09-020, AT&T’s CHCF-B draw as of January 1, 2008, could be offset by an increase of only \$2.08 per residential line per month.¹⁴ Astonishingly, as of July 1, 2009, its entire CHCF-B draw could be offset by an increase of only \$0.76 per month per residential line!¹⁵ These facts demonstrate there is no legitimate need to perpetuate the CHCF-B. It does not make sense that, to avoid comparatively small increases in basic service rates, the Commission would undertake the monumentally difficult and time-consuming tasks of conducting a reverse auction and updating CPM-generated costs using the HM 5.3 Model. Even if “avoidance of rate shock” were still an appropriate regulatory goal, which it is not in a fully competitive marketplace, the comparatively small increases at issue here, as demonstrated by DRA, are hardly in the realm of “rate shock.” They do not constitute a reason for continuing the “high cost fund” in California. As already largely determined in D.07-09-020, it is time to end the CHCF-B program.

¹³ See DRA Comments at 29. DRA’s calculations apparently do not exclude the lines of customers receiving ULTS subsidies, measured service customers, or customers in alleged high cost areas. If appropriate adjustments were made for such customers, the per-line increase needed to offset the loss of CHCF-B subsidies would likely be slightly higher, but the recalculated per-line per-month increase still would not be significant after more than 13 years of no increases at all in AT&T’s basic service rate.

¹⁴ *Id.* at 30.

¹⁵ *Id.* Notably, DRA observes that AT&T may already have pre-funded the reduced CHCF-B draws, *id.*, making the CHCF-B program and/or increases in the basic service rate even more unnecessary.

As discussed below, and as it did so decisively in D.07-09-020 in shrinking the CHCF-B program by 74 percent, the Commission should no longer allow the “fear of rate shock” to govern telecommunications policy. Two years from now, as of January 1, 2010, it will surely be time to discontinue “fear of rate shock” as the driving force of California’s telecommunications regulatory policy. Although the Commission unfortunately (and incorrectly) did not accept, in D.07-09-020, Sprint Nextel’s assessment that the Commission could safely discount “concerns regarding any claimed ‘rate shock’ as a result of immediately lifting the freeze on basic residential rates,”¹⁶ the door is still open for the Commission to reconsider the best means for fully achieving its procompetitive goals within a reasonable period of time. Indeed, while the Commission did not eliminate price caps as of January 1, 2009, it did not foreclose a swift transition from existing, and antiquated, price caps last set in 1994. The Commission should remove all price caps by no later than January 1, 2010,¹⁷ and terminate the CHCF-B program by no later than June 30, 2009.¹⁸ There will then not be any need or occasion for the Commission to design a CASF, conduct a reverse auction or update existing cost proxies.

As the Commission observed in D.07-09-020, “The opportunity to adjust rate levels based upon competitive market forces provides a ready vehicle through which reduced B-Fund

¹⁶ D.07-09-020 at 99.

¹⁷ Previously, Sprint Nextel had favored elimination of basic service price caps as of January 1, 2009 (as the Commission had previously indicated, in D.06-08-030, would occur for all non-CHCF-B-subsidized lines). However, in D.07-09-020 the Commission clarified D.06-08-030 to provide that price caps would not be eliminated for *any* basic service rate, whether supported by the CHCF-B or not, as of January 1, 2009. *See id.* at 97. The Commission’s recently issued D.07-11-039 emphasizes its intention to “avoid sudden large rate increases in basic service.” *See id.* at 3. Accordingly, Sprint Nextel calls for removal of all price caps as of January 1, 2010, leaving the Commission more than two years to provide (or require ILECs to provide) advance notice to consumers that local rates will not be capped after that date.

¹⁸ In Resolution T-17103, dated August 23, 2007, the Commission adopted an expense budget of \$419.5 million for the CHCF-B program through June 30, 2009. The resolution notes the current sunset date for the CHCF-B program of January 1, 2009, “unless extended by the Legislature.” *Id.* at 1. The resolution estimates program costs and revenues through June 30, 2009, but states that, “If the [CHCF-B] fund does sunset, [Communications Division (“CD”)] is preparing procedures to end the program, pay remaining claims and dispose of any balance remaining in the fund.” *Id.* at 2. Even if the Commission requests an extension of its authority to conduct a CHCF-B program, which Sprint Nextel believes the Commission should not do, the Commission should not seek an extension of the CHCF-B program beyond January 1, 2010.

subsidies can be offset.”¹⁹ In this one sentence, the Commission has captured the key to final elimination of the legacy rate design that artificially maintained local rates at below cost levels: the ILECs should have the freedom to adjust prices for basic service based on their assessment of competitive conditions in order to make up for any lost subsidies. With the ability to adjust even basic service rate levels based upon competitive market forces, the ILECs will have a ready means by which *eliminated*, not just *reduced*, CHCF-B Fund subsidies can be offset.²⁰ Accordingly, the Commission can, and should, move as quickly as possible to bring the CHCF-B program to an end.

The Commission’s goal for 2008 should be, above all, quickly putting in place the means required for a full transition to market-based rates for basic service by no later than January 1, 2010. In early 2008, the Commission should use the resources that would otherwise have been devoted to creation of the CASF, designing and conducting a reverse auction, and updating CPM-based costs, to accomplish two critical tasks. First, the Commission should modify the ULTS program to ensure that, in a competitive marketplace, those who require financial assistance in order to purchase basic telephone service will continue to receive such assistance at appropriate levels.²¹ Second, the Commission should modify the ULTS program to ensure that

¹⁹ *Id.* at 81.

²⁰ Even if the Commission does not accept DRA’s estimates of the basic service rate increases required to offset the ILECs’ no longer receiving CHCF-B subsidies, the Commission could easily establish a reliable estimate by requesting the submission of data from CHCF-B recipients.

²¹ Sprint Nextel’s recommendations in this proceeding reflect an assessment of the tasks the Commission will need to complete in R.06-05-028, *Rulemaking on the Commission’s Own Motion to Review the Telecommunications Public Policy Programs*. Among other things, the Commission will have to determine in these two proceedings how large the ULTS program will need to be in order to fund the difference between competitive, market-based rates and the ULTS rate. The level of the ULTS surcharge may need to rise, but this need not be a concern if the CHCF-B surcharge is eliminated as proposed herein. The Commission elected in D.94-09-065 to set the Lifeline rate for basic residential service at 50% of (then) Pacific Bell’s rate. *See In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers*, I.87-11-033, Interim Opinion [D.94-09-065] (1994) 56 CPUC 2d 117, 1994 Cal. PUC LEXIS 681, at *11 (“D.94-09-065”). However, the Commission is not statutorily obligated to set the ULTS rate at 50% of the basic service rate that emerges from market-based competition. Public Utilities Code Section (“PU Code §”) 874, subd. (b), requires only that the Lifeline rate for measured and flat rate service not be more than 50% of the basic rate available to consumers for measured or flat rate service, exclusive of federally mandated end user access charges. Because the Commission is free under PU Code § 874 to set Lifeline basic service rates at any level that is less than 50% of the ILECs’ basic service rates, the Commission may, if it wishes,

all carriers offering basic service or its equivalent are eligible to receive ULTS program subsidies on a competitively and technologically neutral basis. As Sprint Nextel explained through the Frentrup Declaration, basic service rates are unlikely to rise much, if at all, for a host of reasons related to the current structure of local retail markets.²² The Commission need only ensure that consumers, including ULTS customers, are able to choose the services they want, provided by the carriers they select, from the panoply of choices offered by the marketplace. In this manner, the Commission can realize, and consumers can enjoy, the benefits of full competition as envisioned in D.06-08-030.²³

In considering these recommendations, the Commission should keep the following facts in mind. Competitive forces in the retail telecommunications marketplace are strong throughout California, as the Commission itself determined 15 months ago in removing the last remaining controls on ILEC rates for services other than basic service.²⁴ The ILECs' wireline retail services are facing vigorous competition from wireless, cable, and Voice over Internet Protocol ("VoIP")-based service providers.²⁵ Despite having the freedom to do so since the

freeze ULTS rates at existing levels or allow modest increases. Even if it chooses not to freeze ULTS rates, the Commission will safely be able to keep ULTS-supported basic service rates at levels that are well below cost, and well below 50% of non-ULTS-subsidized rates, even as non-subsidized basic service prices rise to market-based levels. The Commission, however, will need to adjust the ULTS surcharge program to ensure that ULTS support payments may be accessed by all carriers on a competitively and technologically neutral basis. The Commission should quickly reform the ULTS program so that ULTS support payments may be accessed by wireless carriers serving ULTS customers. These basic reforms can, and should, be rapidly accomplished by the Commission in R.06-05-028. To the extent necessary under PU Code 1708, the Commission should immediately give notice that it is considering revising D.94-09-065 in order to set ULTS-subsidized basic service rates *at less than* 50% of the ILECs' basic service rates. Such a notice could also signal the Commission's intent to ensure that increases in large and medium-sized ILEC basic service rates do not automatically result in undue increases in the price of basic service provided by California's small local exchange carriers ("Small LECs").

²² Local retail markets are subject to the competitive pressures posed by wireless, cable-based and VoIP service providers. See Opening Comments of Sprint Nextel on Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues, filed November 9, 2007 and available at: <http://docs.cpuc.ca.gov/efile/CM/75049.pdf>. Dr. Frentrup's Declaration ("Frentrup Declaration") is attached as Exhibit 1 to Sprint Nextel's Opening Comments.

²³ See *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the Regulation of Telecommunications Utilities*, R.05-04-005, Opinion [D.06-08-030] (2006) __ CPUC 2d __, 2006 Cal. PUC LEXIS 367 ("D.06-08-030"), modified and limited rehearing granted and rehearing otherwise denied [D.06-12-044] (2006) __ CPUC 2d __, 2006 Cal. PUC LEXIS 511

²⁴ See *id.*

²⁵ See 2006 Cal. PUC LEXIS 367, *385-*392, Findings of Fact 30 through 78.

Commission's adoption of D.06-08-030,²⁶ the ILECs have not engaged in geographic price deaveraging for any services in California, nor, due to marketplace pressures addressed in Sprint Nextel's Opening Comments, are they likely to do so.²⁷ Consumers have an ever widening array of choices for wireless, VoIP and cable-based services that meet their particular needs as the marketplace responds to virtually limitless opportunity. The conditions that necessitated (or at least may then have seemed to necessitate) the creation of a California High Cost Fund ("CHCF-B") program 11 years ago no longer exist. The Commission should end a subsidy program that no longer serves, if it ever actually served, the purpose for which it supposedly was created. The Commission should bring the CHCF-B program to an end as quickly as possible and allow competitive forces and the marketplace to determine the services and prices available to consumers.²⁸

II. THE COMMISSION NEED NOT CONDUCT AN "AFFORDABILITY STUDY."

Two parties – The Utility Reform Network ("TURN") and DRA – used their opening comments to again call on the Commission to conduct an "affordability study."²⁹ While TURN and DRA are to be commended, at least in part, for their labors – TURN for the depth of its discussion of reverse auction issues, and DRA for its clear-sighted recognition of the problems created by using the HM 5.3 Model to "update" CPM-generated cost proxies – the Commission

²⁶ See *id.* at 138-43.

²⁷ See Frentrup Declaration at 8.

²⁸ See Comments of Omnipoint Communications, Inc., dba T-Mobile (U-3056-C) on the Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues, *filed* November 9, 2007 ("T-Mobile Comments") at 2, n. 4 ("T-Mobile continues to maintain that sound public policy considerations favor the complete elimination of the [CHCF-B] Fund. . . . [T]here does not appear to be any further justification for the Fund."). As T-Mobile does, Sprint Nextel recognizes that the Commission appears determined to maintain the CHCF-B program subsidies for the ILECs, at least for a time, despite the fact that such subsidies are anticompetitive and inconsistent with the marketplace envisioned in D.06-08-030. Nonetheless, Sprint Nextel strongly believes that the tasks the Commission now seems poised to embark upon – conducting a reverse auction, updating the high-cost proxies, setting price caps for basic service – are all unnecessary if the Commission simply takes the prudent step of eliminating price caps on basic service as early as possible and, in any event, no later than January 1, 2010.

²⁹ See Comments of The Utility Reform Network on the Assigned Commissioner's Ruling Regarding the Scope and Scheduling of Phase II Issues, *filed* November 9, 2007 ("TURN Comments") at 45-46; see DRA Comments at 4-5.

should reject their calls for an “affordability study.”³⁰ Such a study is unnecessary, would be misleading, and would not have any practical value.³¹

From an economist’s perspective, an “affordability study” makes no sense. How much consumers are willing to spend on a service is a function of their preferences and their income. Conceivably, if the charge for local phone service exceeded each and every person’s monthly income, an economist might say it was “unaffordable,” but other than that impossible scenario, no reasonable economist would ever term a service “unaffordable.”

What TURN and DRA are asking for would actually require a two-part process. First, it would require the estimation of the demand function for local telephone service. This demand function would have to include the effects of changes in the price of local telephone service, consumers’ incomes, and the prices of other relevant goods. In principle, this demand function would describe how consumers would respond to price changes for basic local phone service. But that would be only part of the picture.

Changes in consumer incomes and in the prices of other goods would also affect the quantity of local telephone service demanded, and in fact might offset any changes in the price of local telephone service. For example, if incomes and prices for local telephone service rose by the same percentage, consumers would face no effective increase in the price of local telephone service. Similarly, with the recent increase in gasoline prices, consumers’ demand for local telephone service might actually be stronger than the historical data would suggest, as they would be more inclined to use the telephone as a way of avoiding more expensive trips in their automobile.

³⁰ Conducting an “affordability study,” or contracting with an outside party, such as the Field Research Institute, to do so, would create yet another resource drain, both for the Commission and for all parties.

³¹ Sprint Nextel’s opposition to an “affordability study,” like its opposition to prolonged continuation of the CHCF-B program, should not be misconstrued as opposition to continuation of the ULTS program. Sprint Nextel supports continued provision of assistance on a means-tested basis through the ULTS surcharge. Sprint Nextel opposes the continuation of subsidies that are not means-tested and unfairly deprive consumers of the benefits of competition.

A valid assessment of demand for local telephone service would therefore require the Commission both to estimate the demand function, and to develop projections for the changes in: (1) the price of local telephone service if the price cap expires; (2) consumer incomes, and; (3) the prices of other relevant goods. As Sprint Nextel explained through the Frentrup Declaration, at present market forces are such that it is unlikely that ILECs will attempt to impose price changes that are substantial or significant in any material respect.³² In addition, developing projections for changes in California consumers' incomes and in the prices of the other relevant goods would require the Commission to obtain expertise outside the telecommunications industry with which it is familiar. At present, any assumptions regarding expected changes in prices or incomes would require the Commission to engage in speculation, as there is virtually no record to support such assumptions.

The Commission should examine what has happened to prices and incomes in California since basic service rates were last set in 1994.³³ Since 1994, the Consumer Price Index ("CPI") has risen by 41%, according to the Bureau of Labor Statistics ("BLS").³⁴ From 1994 to 2006, per capita personal income in California rose from \$23,203 to \$39,358, a 70% increase.³⁵ In 1994, the penetration rate in California was 94.8% versus 96.2% in March of 2007. As T-Mobile commented, "... there is no indication that the [CHCF-B] Fund has affected overall penetration in any way over these past 10-plus years."³⁶ There is no evidence that the CHCF-B Fund was

³² Assume, for example, that the price of AT&T's basic service rose by \$3.43 per month, the amount that DRA estimates AT&T would need to offset the loss of current CHCF-B subsidies. Such an increase, assuming AT&T were to attempt it, would likely not be viewed by most non-ULTS-subsidized customers as significant in any respect.

³³ See D.94-09-065, *supra*.

³⁴ BLS statistical information is accessible through the BLS Web site at: <http://www.bls.gov/cpi/>.

³⁵ Per capita personal income by state is available from the Commerce Department's Bureau of Economic Affairs website at <http://www.bea.gov/regional/spi/>. Table SA04 on that website contains the data used here.

³⁶ T-Mobile Comments at 3; *see also id.* at 7.

necessary in 1996 for achievement of a 95% penetration rate, nor is there any evidence that the CHCF-B Fund is necessary for this purpose in 2007.³⁷

Thus, real prices fell, and incomes rose, substantially from 1994 to 2007. It is a truism of economic theory that falling prices should cause the quantity purchased to rise, and rising incomes should have the same effect.³⁸ Thus, both of the changes noted above should have resulted in more purchases of local phone service, if the price and income elasticities of demand were significantly different from zero. However, there was minimal change in the local service penetration rate. From this fact, the Commission should conclude that the price and income elasticities of demand for local phone service are very nearly zero. Thus any foreseeable change in the price of basic service will have minimal effect on penetration rates for non-ULTS-subsidized customers. Further, the price of local phone service can be allowed to fluctuate as the market dictates without impacting penetration rates. For all of the reasons addressed in Dr. Frentrup's Declaration, there will likely not be much fluctuation in local service prices, but even if a price increase did occur, consumer behavior in California since 1994 suggests that it would have little effect on telephone service penetration rates. Approximately 95% of all households will continue to purchase local phone service.³⁹

³⁷ Taking a somewhat longer term view, from 1984 to 2007 the Consumer Price Index essentially doubled (according to the BLS), and per capita disposable personal income in California rose by 139% (according to the Bureau of Economic Analysis of the Commerce Department, accessible at: <http://www.bea.gov/>). Thus, nominal prices could have risen by this 139% and the effective price of local phone service would be the same today as it was in 1984. In fact, however, the nominal price remained the same, since it was controlled by the Commission. Yet, even with the very substantial real price cut that consumers enjoyed from 1984 to today, the local service penetration rate in California rose only from 92.5% in 1984 to 96.2% in March, 2007. There is no evidence to support the view that the modest increase in the penetration rate that did occur was attributable to the Commission's imposing a price cap on basic service rates. From the fundamental economic facts that are available, the Commission could properly conclude that allowing the price of basic local phone service to be determined in the marketplace would have essentially no effect on basic local service penetration rates.

³⁸ There are what economists term "inferior goods," which are those goods of which less is purchased as income rises. There is no indication that telephone service is an example of an "inferior good."

³⁹ This accords with common sense: people need phone service (of one kind or another) and, as long as the price is not "clearly unreasonable," they are going to arrange their affairs in such a manner that they continue to buy it. The Commission need only determine that the price set by the marketplace for basic local phone service is not "unreasonable," *cf.* Public Utilities Code § 451 (requiring "just and reasonable" rates). If the Commission finds that

Perhaps a different example can illustrate the same point. In the last six years the nominal price of gasoline has increased by approximately \$2.00 per gallon,⁴⁰ with the result that it now typically costs \$30 or more than it previously did to buy a tank full of gasoline. In general, the increase in the past year alone in California has been approximately \$1.00 per gallon, or, for a typical car or typical pickup truck seen in rural areas, approximately \$15 per tank.⁴¹ It is hardly uncommon for a typical family in the United States, particularly in suburban and rural areas that lack adequate public transportation, to buy two tankfuls of gas in a single week – meaning that a typical family might face increased gasoline expenses of \$30 to \$60 or more per month. Persons owning and/or operating automobiles or pickup trucks have now been forced to “afford” these increases (if they wanted to continue driving a private vehicle), even though, if they had been surveyed five years or even one year ago, most if not all would have said that such increases were not “affordable.” Clearly, what would have been deemed “unaffordable” became “affordable” through adjustment of other factors, such as income and expenses, as a simple fact of life.⁴² In short, asking people what they considered “affordable” would have been, and still would be, a pointless exercise.

the price is not “unreasonable,” then it should also find that, given the competitive forces in the marketplace, its “high cost” subsidy work is done, *i.e.*, that a CHCF-B Fund is no longer necessary.

⁴⁰ See “Retail Gasoline Historical Prices,” accessible through http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_history.html, a website maintained by the Energy Information Administration (“EIA”) of the United States Department of Energy.

⁴¹ See http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_home_page.html. According to the EIA, the price of regular grade retail gasoline as of November 12, 2007, had increased by 90.2 cents compared to a year ago. Plainly, this increase has not occurred uniformly or in a single bound, but the fact is that prices have increased approximately 50% in only 12 months, without major social or economic dislocation.

⁴² It might be that consumers’ short run price elasticity of demand was very small, *i.e.*, essentially zero, because they had no options, in the short run, to continuing to purchase gasoline. Over a longer period, some consumers undoubtedly found “substitutes” in the form of more efficient cars, shorter commutes, telecommuting, carpooling, bicycling or walking, etc., to reduce their gasoline consumption. While it is possible that overall demand declined, as consumers may in fact have bought less gasoline since prices rose, the larger point is that consumers “figured it out” by successfully adjusting to changed prices. The same thing would happen with a change in basic service rates, and those with limited means, *i.e.*, those subsidized by the ULTS program, would not see any price increase at all, making it unlikely that there would be any decrease in demand for telephone service in California if basic service prices increased to the small extent forecasted by Dr. Frentrop.

Given the “affordability” of such substantial increases in gasoline, a commodity even less essential than basic residential telephone service, it is simply not credible to argue that far smaller increases in the price of basic telephone service of, say, \$10 to \$15 per month would not be “affordable” for non-ULTS-subsidized customers, or that “rate shock” would occur, or that there would be a significant impact on telephone service penetration rates in California.⁴³ Indeed, the proof that such claims are not credible is readily at hand. As AT&T’s Comments indicate, the cost of basic service provided by SureWest in the Roseville area is more than \$10 per month higher than it is in directly adjacent Sacramento.⁴⁴ Yet there are no data indicating that telephone service penetration levels are lower, or, if lower, lower on a statistically significant basis, in Roseville than in Sacramento or elsewhere in AT&T’s service territory. Nor is it even remotely likely that if such data were available it would reveal lower penetration levels. In short, the price elasticity of demand for phone service in California is very low. AT&T’s basic service price of \$15.08 (including the end user common line (“EUCL”) charge) could likely increase by \$10.32 to \$25.40 (the price charged by SureWest (including EUCL)) as of January 1, 2010, with virtually no measurable impact on penetration rates or achievement of universal service goals.⁴⁵

⁴³ Whether, and if so, how much ILECs might increase their prices in response to the elimination of price caps on basic service in California calls for speculation regarding a host of factors. Whether the increase, if any, might be more, or less, than \$10 to \$15 is obviously unknown. Sprint Nextel believes, however, that the ILECs are unlikely to attempt to effect, much less be able to sustain, large price increases. See Frentrup Declaration at 8.

⁴⁴ See Phase II Comments of AT&T California *et al.*, filed November 9, 2009 at 22.

⁴⁵ Likewise, there are no data that indicate that there are lower telephone service penetration levels in Verizon’s service territories, where the price of basic service (including the EUCL) is \$23.75. See *id.* For example, the Commission has received no information indicating that areas served by Verizon in and around metropolitan Los Angeles have lower penetration rates than adjacent areas served by AT&T. Thus, it is apparent AT&T’s basic service price could increase by 58% virtually overnight without any statistically significant impact on achievement of universal service goals. These facts are virtually indisputable, yet for the last 13 years it has appeared that any mention of an increase in AT&T’s basic service rate was simply “off the table” for discussion. Now, for the benefit of all consumers, it is time to reexamine the old notions that have guided policy in California.

According to TURN, the nationwide median total monthly charge for flat rate service, including the EUCL and fees and taxes, is \$24.22.⁴⁶ Thus, allowing AT&T's basic service rate (including the EUCL) to increase to approximately \$25 per month could not reasonably be deemed "unaffordable," as it seems to be quite "affordable" in the rest of the country. Allowing the basic service rate to rise to this level could not reasonably be termed an occasion for "rate shock." And, as stated above, in the wake of D.06-08-030 having been issued some 15 months ago, it is now well past time for the Commission to cease regulating basic service rates on the basis of "fears of rate shock."

With these facts in mind, the Commission should authorize (but not require) AT&T, for example, to gradually increase its existing price cap up to the level of SureWest's basic service rate (including the EUCL), with elimination of all price caps as of January 1, 2010.⁴⁷ The Commission should authorize (but not require) Verizon, SureWest and Frontier to effect similar price cap increases (*e.g.*, at the same percentage as authorized for AT&T), and to consider price caps eliminated, on the same dates. For non-ULTS-subsidized customers, these would not be significant increases and, for ULTS-subsidized customers, with proper reforms to the ULTS program, there need not be any increase at all or anything beyond modest increases.⁴⁸

Even TURN agrees that ILECs should be allowed to increase their basic service prices by 10% per year.⁴⁹ Thus, TURN is implicitly agreeing that it would be reasonable for SureWest to charge up to \$27.94 in 2009, \$30.73 in 2010, and \$33.80 in 2011. Even a \$33.80 price would be less than half of the average amount of money, \$82.50, that American consumers typically spend

⁴⁶ See TURN Comments at 14 and n. 13, citing information from the 2007 FCC Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service.

⁴⁷ The \$5.16 figure represents one-half of the amount needed to bring AT&T's basic service rate (including the EUCL) to the current basic service rate (including the EUCL) by SureWest Telephone.

⁴⁸ See n. 20, *supra*.

⁴⁹ See TURN Opening Comments at 49.

per month on telecommunications services.⁵⁰ If these prices are reasonable and affordable for the customers of SureWest, which Sprint Nextel believes they surely are, they should also be reasonable and affordable for AT&T's customers.⁵¹ The inevitable cries that such rates would not be "affordable" for AT&T's customers simply do not withstand scrutiny – it would be absurd to argue that such prices were "affordable" in Roseville but "unaffordable" in Sacramento next door. To the maximum extent possible, the Commission should base its public policy decisions on facts such as these, rather than on pleas for delay submitted in the guise of requests for "affordability studies" that will likely require a year or more to complete.⁵²

The bottom line is that customers served by the ILECs' competitors are being taxed (surcharged) to subsidize the ILECs' prices. As DRA recognized, it is highly likely that the ILECs receiving CHCF-B program funds are receiving more money than they actually need to provide service in the alleged high cost areas.⁵³ The current approach is neither technologically

⁵⁰ In a previous filing in this proceeding, namely, its Comments in Response to the [February 23, 2007] Assigned Commissioner's and Administrative Law Judge's Ruling Soliciting Further Comments, *filed* April 27, 2007 and available at <http://docs.cpuc.ca.gov/efile/CM/67258.pdf>, which are incorporated herein by this reference, Sprint Nextel provided the Commission with access to extensive factual information concerning wireless carriers' coverage throughout the State of California and, just as importantly, with access to information concerning the amount, \$82.50, and the percentage of all consumer expenditures, approximately 2%, that is typically being spent every month on telecommunications services by consumers in the United States. *See id.* at 11-14. (Those who complained that the data referenced by Sprint Nextel were not "California data" have never provided any reason to believe that data true of the United States as a whole would not also be true of California as a whole.) This data showed that, even making the most conservative assumptions, it was reasonable to conclude that a price of \$30 per month for basic telephone service – less than half of what people spend on telecommunications overall – would be "affordable" by most, if not all, non-Lifeline-subsidized customers. The data provided by Sprint Nextel are all the "affordability data" the Commission requires for addressing the issues posed in Section 3.1 of the ACR.

⁵¹ As anyone who has driven through Roseville recently could easily attest, where Sacramento ends and Roseville begins is virtually undetectable. There is no practical difference in the service territories of AT&T and SureWest in this area, even if there may have been in 1996 or before.

⁵² For example, DRA argues that "... the Commission should not lift the interim rate cap or set a new, permanent cap until it obtains geographically and demographically disaggregated baseline information about penetration rates in California and customer perceptions of affordable basic service rates (both for low-income and average-income customers." DRA Comments at 27. Under DRA's apparent strategy for delay of market-based prices for as long as possible, SureWest's current rate would remain the interim price ceiling for all carriers and other carriers could increase their rates by "an absolute maximum" of "\$2.00 per year" (presumably, DRA means "\$2.00 per month" but this is not entirely clear). *See id.* at 27, 29. Astonishingly, DRA is concerned that even an increase of as little as \$2.00 per year would be an "inordinately large single year increase for some customers." While this might be true for ULTS-subsidized customers, it simply is not credible that an increase of \$2.00 per year or even \$2.00 per month would not be "affordable" for non-ULTS-subsidized customers.

⁵³ *See* DRA Comments at 19-20 ("[T]here is substantial evidence that CHCF-B payments have been much higher than what COLRs actually spend on maintaining residential universal connectivity" (fn. omitted)).

nor competitively neutral, nor is it socially just, either. The Commission should cease regulating basic service prices on the basis of mythic notions about rural areas in which all residents have limited means for confronting changes in the prices of any commodity or service. Myths created by the original (pre-divestiture) AT&T (or by the newly “reassembled” AT&T) *to prevent competition* should no longer control telecommunications policy. The Commission should not continue a system whereby millions of business and residential customers are taxed so that a comparative handful of people living in alleged high cost areas (where they *choose* to live) can continue to receive subsidized basic service.⁵⁴ Whether or not such an approach was appropriate in 1996, when the CHCF-B program was conceived, or 1994, when basic service rates were last fixed, it surely is not appropriate now. Since 1996, the ILECs have not only incurred, on the whole, sharply lower costs for provision of their traditional basic service,⁵⁵ they have also discovered a wide range of new uses, such as Internet access, broadband and other information services, for the facilities (*e.g.*, copper loops) they asserted, wrongly, that competition would make obsolete. The new services have presented correspondingly large and exciting opportunities for new revenues, as the comparative importance of voice services declined. To continue a supposed “high cost” subsidy program in these circumstances can no longer be squared with sound public policy. The Commission does not need an affordability survey; it needs, rather, to bring the CHCF-B program to an end as of January 1, 2010 (as Sprint Nextel recommends) or as soon thereafter as possible.

⁵⁴ What is surprising about consumer representatives’ continued support for a high cost fund is their nearly complete disregard for the cost that the CHCF-B program regressively imposes, in the same manner as a sales tax, on those with lower incomes in non-high cost areas: such persons are forced to pay the tax (*i.e.*, the CHCF-B surcharge) for the benefit of those living in alleged high cost areas, whether such residents personally require a subsidy or not and regardless of the reasons such persons choose to live in such areas. Continuing the high cost fund program and the CHCF-B surcharge cannot be reconciled with basic notions of equitable social policies and eliminating taxes that fall most harshly on the poor.

⁵⁵ See TURN Comments at 44, n. 45 (referencing decline in the ILECs’ input prices and the grounds on which the ILECs’ (AT&T’s and Verizon’s) mergers were approved, *i.e.*, the cost-saving “synergies” they would produce. It is time for the Commission to take the claimed “synergies” into account in determining policy in California.

III. THE COMMISSION SHOULD FORGO THE REVERSE AUCTION.

In its August 23, 2007 Opening Comments on the Proposed Decision of Commissioner Chong in this proceeding,⁵⁶ Sprint Nextel urged the Commission not to devote resources to conducting a cost proxy proceeding but instead to focus on conducting a reverse auction for selection of multiple carriers of last resort.⁵⁷ At that time, asked to comment on the relative desirability of conducting a reverse auction versus conducting a cost proxy proceeding, Sprint Nextel had little doubt, and still has little doubt, that the Commission would do best to focus its limited resources on the design, conduct and implementation of a reverse auction. *If the only choices* before the Commission were (a) conduct a reverse auction and/or (b) conduct a cost proxy proceeding, Sprint Nextel would still endorse a reverse auction as the better of two unsatisfactory options. However, these are not the only choices available to the Commission, and based upon review of the parties' Opening Comments on the ACR, Sprint Nextel has now concluded, as explained above, that the Commission should not attempt to conduct *either* a reverse auction *or* a cost proxy update proceeding.

As TURN pointed out, a reverse auction for the right to receive a subsidy for providing telephone service as a COLR has not previously been successfully carried out anywhere in the world.⁵⁸ The Commission has no model to look to for guidance. One of the parties, Citizens Telecommunications Company of California, Inc. d/b/a Frontier Communications of California ("Frontier"), unambiguously has declared that it "... is opposed to universal [service] funding being provided and determined based on competitive bidding or a reverse auction."⁵⁹ Any party, such as TURN, Frontier, or others, that was opposed to the auction could introduce considerable

⁵⁶ See R.06-06-028, Proposed Decision of Commissioner Chong, *filed* August 3, 2007 and available at: <http://docs.cpuc.ca.gov/efile/PD/70974.pdf>.

⁵⁷ See Opening Comments of Sprint Nextel on Proposed Decision of Commissioner Chong, *filed* August 23, 2007 and available at: <http://docs.cpuc.ca.gov/efile/CM/71672.pdf>, at 11-14.

⁵⁸ See TURN Comments at 1, 38.

⁵⁹ Comments on Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues, *filed* November 9, 2007 ("Frontier Comments") at "2" [sic].

uncertainty and roadblocks to the process through initiating litigation that would quickly exhaust parties' appetites, if any, for a reverse auction.

TURN, in particular, persuasively explained how the manner in which the Commission structures the reverse auction could influence not only bidding strategies but also substantive outcomes.⁶⁰ TURN showed how the Commission is likely to encounter numerous subtleties and difficult choices in attempting to design a reverse auction. The structure of the auction will affect the number of potential bidders and whether it has any prospects for success. Yet, at this time, the structure of the auction is unknown, and there is no agreement among the parties as to how it should be structured.⁶¹ To take but one of many instances where the parties do not agree, AT&T and Verizon (as the incumbents) believe there should be one, and only one, COLR that could draw CHCF-B program funds after the auction, but Cox and T-Mobile believe that any eligible carrier should be able to receive a per line or per customer subsidy if it is willing to provide the service prescribed by the Commission in an alleged high cost area.⁶²

The difficulties of designing an auction and implementing its outcome will be formidable.⁶³ TURN, AT&T, DRA and Verizon have raised numerous issues that will require extended consideration.⁶⁴ The Commission would commit a serious error if it underestimated

⁶⁰ See, e.g., TURN Comments at 16-22 and 32-37; see also Verizon Comments at 3. TURN deserves credit for its thorough job of explaining how difficult it will be for the Commission to design, conduct, and implement a reverse auction, let alone to manage the transition to whatever results the auction may produce.

⁶¹ In comparing the comments submitted by AT&T, Verizon, DRA, and TURN, it is readily evident that there is no consensus among the parties. Not only is there no consensus, there is no clear yardstick for measuring which suggestions from the parties would be most likely to produce a successful auction. In these circumstances, the Commission faces innumerable difficulties, and at the end of the process of designing an auction, parties other than ILECs may simply decide that matters have been so completely arranged in the ILECs' favor that there is no point to participating. Given the small number of potential bidders in the first place, the likelihood of such an outcome cannot be discounted.

⁶² Cf. AT&T Comments at 4 and Verizon Comments at 10 with Cox Comments at 2 and T-Mobile Comments at 9. Sprint Nextel will not catalog all of the disagreements among the parties, but they are legion.

⁶³ This will be especially true if the incumbent local exchange carrier ("ILEC") is not "the winner" of the auction, assuming that the process is structured (mistakenly) to permit only one party to be "the winner" and only one party to receive high cost support payment from the California High Cost Fund-B ("CHCF-B") program.

⁶⁴ See, e.g., TURN Comments at 4-20 and 32-37 and Verizon Comments at 3-5 and 6-12. Verizon urges the Commission to seek further comments, given the difficulty of the issues. *Id.* at 5.

the difficulties it faces in attempting something that has not been done previously.⁶⁵ After holding an intensive workshop, the Commission should not proceed without first conducting a pilot effort.⁶⁶ Realistically, by the time that the Commission has conducted a workshop, resolved all of the issues (assuming it can do so), issued a decision describing the auction, resolved applications for rehearing, issued a request for quotes, conducted a pilot auction and assessed the results, years will have passed. It is quite conceivable that it will be 2011 or 2012 before the Commission is ready, if ever, to conduct the multiple auctions it will need to conduct for different areas in California. By the time it is ready to conduct a reverse auction, the Commission should instead have terminated the CHCF-B.

The time and expense required to resolve the innumerable difficulties ahead are disproportionate to the benefits, if any, that might be gained from the effort. In particular, given the opening comments, the likelihood that a Commission workshop would produce agreement among the parties on how a reverse auction should be structured is very small – especially when the parties are still unsure what they will be bidding on, and who the eligible bidders will be, and further when the parties can easily foresee how the auction design might either help or hurt their chances in bidding for CHCF-B support. Realistically, this means that the Commission will find it virtually impossible to design and conduct a technology neutral and competitively neutral reverse auction in each of the four major ILECs' service territories within a reasonable period of time. In Sprint Nextel's view, TURN's and other parties' comments demonstrate that the Commission should not attempt to conduct a reverse auction. Although in theory it is an admirable idea, in practice it will require too many resources, take too long, impose too many costs, prove much too complex and contentious, and almost certainly fail. In short, the

⁶⁵ See Opening Comments of Sprint Nextel on Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues, *filed* November 9, 2007 and available at: <http://docs.cpuc.ca.gov/efile/CM/75049.pdf>, at 3.

⁶⁶ See Verizon Comments at 15; see DRA Comments at 12; see TURN Comments at 38; see AT&T Comments at 12.

Commission should scratch this option. It will involve a lot of work for a very limited goal – to determine the amount of subsidy needed in so-called high cost areas when the Commission has already found, in D.06-08-030, that there is vigorous competition throughout California.⁶⁷ The Commission would do best to conclude that it does not need a high cost fund at all and instead to turn the attention of all service providers to bidding for and winning customers in the marketplace rather than working to perpetuate their advantages in bidding for regulatorily-created subsidies.⁶⁸

IV. THE COMMISSION SHOULD FORGO ANY COST PROXY UPDATING USING THE HM 5.3 MODEL.

Just as parties' comments disclose a wide divergence of views on the structure and value of a reverse auction, so do parties' comments reveal large disparities in their views on use of the HM 5.3 Model in this proceeding.

At the outset, it should be observed that there are few tasks in telecommunications regulation that would be more certain to prove contentious and time-consuming than using the HM 5.3 Model to update CPM-generated costs, identify alleged high cost areas, and determine appropriate "reserve" bidding levels for a reverse auction.

Start, for example, with the comparatively simple question of whether the HM 5.3 Model needs to be modified for any of these purposes. AT&T states that, "No other adjustments to the

⁶⁷ See D.06-08-030.

⁶⁸ Ironically, AT&T foresees the possibility that no auction would be held in a supposed high cost area. AT&T argues that, "... if the existing COLR states that it is willing to remain the COLR in a high-cost CBG without any subsidy, that CBG should be removed from the auction." As AT&T notes, "By definition, the auction cannot possibly yield a lower bid in that circumstance." (AT&T Comments at 11.) While this point is correct, it appears that the larger point is that the area in question no longer is (and perhaps never was) a high cost area. The flip side of AT&T's observation is that it serves as prelude for AT&T to argue that the existing COLR should also be allowed to identify additional, *i.e.*, *new*, areas that require high cost support (*see* AT&T Comments at 14 ("It is quite likely the update will reveal new high-cost areas that would require support . . .")). AT&T also argues that there should be no cap on the cost proxies generated by HM 5.3 Model (*id.* at 15). Evidently, having run the model, AT&T foresees that use of the HM 5.3 Model will lead to "discovery" of new "high cost" areas and *much* higher cost proxies, all leading to more money for the ILECs. Allowing AT&T to use HM 5.3 to "reveal" new high cost areas and new, even higher cost proxies will simply make the use of that model all the more contentious and time-consuming, and constitutes yet another reason for not undertaking an "update" using the HM 5.3 Model.

HM 5.3 should be considered.”⁶⁹ In contrast, Verizon sees that, “Some adjustments will be required to update the model or to make the model usable for all areas in California,” and “some will be required because of the determinations made by the Commission in D.07-09-020,” such as “census-block group deaveraging calculations.”⁷⁰ One has to admire the deft use of understatement in Verizon’s assessment that “some adjustments” will be required. According to Verizon, “. . . carrier specific inputs in the base model will need to be analyzed and potentially updated and/or modified.”⁷¹ Verizon also recommends “. . . a limited number of platform changes.”⁷² At this early stage, it is not possible to know exactly how many changes Verizon (and for that matter AT&T) really has in mind.

In contrast to the ILECs, DRA describes “. . . a problematic issue relative to the use of CBG-level results from HM 5.3” that systematically overestimates the cost of universal service. According to DRA, “. . . HM 5.3 estimated . . . *five times more distribution cable* relative to the amount of distribution cable [that] Verizon itself modeled and claimed was necessary.”⁷³ DRA describes also how “. . . some of Verizon’s customer location data used as inputs to HM 5.3 included locations that ‘geocoded’ to areas far outside Verizon’s actual service boundaries.”⁷⁴ In view of DRA’s concern that “. . . there is a substantial possibility that COLRs would receive windfall payments . . . based on anomalously high results from HM 5.3 . . . ,”⁷⁵ the Commission would not be acting in a prudent manner if it foreclosed parties from showing why the HM 5.3 Model needed to be modified. DRA advocates “. . . three potential ‘work-arounds’ for ensuring

⁶⁹ AT&T Comments at 20. By “no other adjustments” AT&T means “no adjustments.”

⁷⁰ Verizon Comments at 19.

⁷¹ *Id.*

⁷² *Id.* at 20.

⁷³ DRA Comments at 16 (emphasis in original).

⁷⁴ *Id.* (fn. omitted).

⁷⁵ *Id.* As mentioned above, DRA forecasts that Verizon’s high cost payments would more than double through use of the HM 5.3 Model. *Id.* (DRA does not provide a similar forecast of the possible increase in high cost payments to AT&T, but it seems very likely that, given AT&T’s embrace of the model, it foresees that it will do very well should the Commission attempt to use it for purposes other than pricing UNEs.)

that subsidy payments are not inflated as the result of anomalous HM 5.3 results.”⁷⁶ The likelihood that DRA’s “work-arounds” will be acceptable to the ILECs is probably very small. Once other parties have a clearer sense of what the Commission may attempt through use of the HM 5.3 Model, they will likely suggest changes to the model as well.

This is but one of the many issues the Commission will confront in attempting to apply the HM 5.3 Model in this proceeding. Given the past opposition of AT&T and Verizon to use of the HM 5.3 Model in connection with setting their unbundled network element (“UNE”) prices, their general embrace of the model now suggests that they have run the model and they like the results.⁷⁷ In AT&T’s case, since AT&T calls for no changes at all,⁷⁸ it must *really* like the results.⁷⁹ This alone should serve to put the Commission on high alert to the likely need for

⁷⁶ *Id.* at 18; *see* DRA Comments at 18-20.

⁷⁷ It is rather a wonder that Verizon is not holding parades in support of the HM 5.3 Model: in its proceeding to determine Verizon’s UNE prices, the Commission determined that the Zone 3 and Zone 4 basic two-wire UNE loop price would be \$134.74 and a whopping \$525.70, respectively. *See Rulemaking on the Commission’s Own Motion to Govern Open Access to Bottleneck Services and Establish A Framework for Network Architecture Development of Dominant Carrier Networks*, R.93-04-003; *Investigation on the Commission’s Own Motion into Open Access and Network Development of Dominant Carrier Networks*, I.94-03-002; Opinion Establishing Unbundled Network Element Rates and Price Floors for Verizon California and Modifying Decision 99-11-050 Regarding Monopoly Building Blocks [D.06-03-025] (2006) __ CPUC 2d __, 2006 Cal. PUC LEXIS 107, Appendix A, *modified*, Decision Granting, in Part, the Petitions of Verizon California, Inc. (Verizon) and Verizon/Covad Communications Company to Modify D.06-03-025, [D.07-10-033] __ CPUC 2d __, 2007 Cal. PUC LEXIS ___. Given the UNE prices established for Verizon in D.06-03-025, it is not surprising that DRA forecasts that use of the HM 5.3 Model would result in significantly larger CHCF-B draws for Verizon. *See* DRA Comments at 17.

⁷⁸ AT&T states: “The Commission should not adopt any adjustments to HM 5.3 in the name of streamlining the update process. . . . There is no need to reinvent the wheel here. Giving parties another chance to litigate over any inputs and assumptions will simply encourage them to put forth self-serving proposals that will take time to evaluate and litigate. The parties and the Commission would then be bogged down in litigation” AT&T Comments at 20-21. AT&T and Sprint Nextel agree, therefore, that attempted use of the HM 5.3 Model poses a large risk that the Commission will be “bogged down” in litigation. For AT&T, the risk means “don’t change the model.” For Sprint Nextel, however, the substantial risk of delay means, “Don’t ‘update’ costs and don’t use the model, but instead bring the CHCF-B program to a close as quickly as possible.”

⁷⁹ Viewed from a high level, the HM 5.3 Model seems, at first glance, to produce reasonable costs. Take UNE loop costs, for example. The costs that come most readily to mind are the “final” UNE costs, but it must be kept in mind that these are an *average* of high and low cost wire centers. For example, the ZONE 1, 2, and 3 two-wire UNE loop costs of AT&T in California, per D.04-09-063, are: \$9.64, \$13.01 and \$26.87, respectively (statewide average two-wire UNE loop cost is only \$11.93). *See Joint Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching in its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050*, A.01-02-024 and related proceedings, Opinion Establishing Revised Unbundled Network Element Rates for Pacific Bell Telephone Company dba SBC California [D.04-09-063] __ CPUC 2d __, 2004 Cal. PUC LEXIS 476, Appendix A. Even the ZONE 3 two-wire UNE loop price of \$26.87 represents an average of high and low cost two-wire UNE loops. If, however, the Commission disregards the low cost loops in Zone 3, it is left with only the high cost loops, “the highest of the high,” which will likely be far more than just \$26.87. Sprint Nextel does not have

reevaluating how suitable the HM 5.3 Model is to achievement of the purposes being asked of it. In any event, the idea that competitors will simply allow AT&T and Verizon to manipulate the HM 5.3 Model to produce anticompetitive windfall subsidies for alleged high cost areas without opposition or delay should be regarded as unrealistic in every possible respect. It is highly unlikely that, with the other tasks it has set for itself, the Commission could use the HM 5.3 Model in this proceeding within the period of time when, as Sprint Nextel recommends, it should already have brought the CHCF-B program to an end.

Conclusion

In D.06-08-030, the Commission unambiguously declared: “The Commission should end all the vestiges of the outdated NRF framework and rate-of-return regulation.”⁸⁰ With equal directness, the Commission concluded: “The Commission should eliminate price caps”⁸¹ Now, however, having finally reached the point at which it can properly accomplish these goals, the Commission has apparently pulled back, preferring to keep basic service price caps in place for what may turn out to be an indefinite period of time. While a desire to avoid “rate shock” is certainly understandable, the facts discussed above do not support predictions of “rate shock,” much less allowing “fear of rate shock” to prolong the life of the CHCF-B program, and still less to retain the CHCF-B program in order to fund the CASF experiment. Such predictions do not, in any event, justify conducting a reverse auction or using the HM 5.3 Model to update the CPM-generated cost proxies.

Removal of existing price caps by no later than January 1, 2010 would eliminate any need or occasion for perpetuation of the high cost fund. It would also eliminate any need or

access to the disaggregated costs (although AT&T does, since it now owns whatever rights old AT&T had to the model), but they are almost certainly very high. Whenever the HM 5.3 Model is run at a geographically disaggregated level, it will yield greater subsidy amounts. AT&T would know this even without running the model, but it is certain that it has run the model and likes the results, even without any changes.

⁸⁰ *Id.*, 2006 Cal. PUC LEXIS 367, *407.

⁸¹ *Id.*

occasion for conducting a reverse auction or for updating the cost proxies. This would save the Commission, as well as the parties, from complex, costly, contentious and, above all, time-consuming tasks that seem destined to end in failure. The Commission should acknowledge that the entire rationale on which the CHCF-B program was constructed has now been superseded by vast, previously unimaginable changes in the marketplace, in technology and in regulation. As the Commission itself found in D.06-08-030, consumers now have, readily at hand, competitive alternatives to services provided by the ILECs. These alternatives now offer consumers throughout California an easy means to avoid any ILEC attempt to exact exorbitant rate increases from their customers.

As there is no longer any legitimate reason or need to continue the CHCF-B program, there is no reason or need to conduct a reverse auction or update cost proxies. This is especially true when, as now, the anti-consumer and anticompetitive impacts of the CHCF-B program are so evident. The Commission should eliminate existing price caps by no later than January 1, 2010 and eliminate the CHCF-B program by not later than the same date.

[signature page follows]

Respectfully submitted:

SPRINT NEXTEL

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Dated: November 28, 2007

Certificate of Service

I, Earl Nicholas Selby, hereby certify that, on November 28, 2007, I caused a copy of the foregoing document, entitled:

**REPLY COMMENTS OF SPRINT NEXTEL
ON ASSIGNED COMMISSIONER'S RULING
REGARDING THE SCOPING AND SCHEDULING OF PHASE II ISSUES**

to be served on the parties to this proceeding by electronic mail to the electronic mail addresses on the service list maintained on the Commission's Web site for this proceeding, as indicated on the following page.

I also certify that, on November 28, 2007, I caused a copy of the foregoing document to be served on the following persons at the California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, CA 94102, by United States Mail, first class postage prepaid:

Commissioner Rachelle B. Chong, Advisor Robert Haga, and Administrative Law Judge Thomas R. Pulsifer. I further certify that, on November 28, 2007, I caused a copy of the foregoing document to be served on: La Tanya Linzie, Cox California Telcom, LLC, 2200 Powell Street, Suite 1035, Emeryville, CA 94608, by United States Mail, first class postage prepaid.

I certify that the above statements are true and correct.

Dated: November 28, 2007 at Palo Alto, CA.

/s/
Earl Nicholas Selby

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